

3 Reasons Your Incentive Plan Could Fail





THE VISIONLINK
ADVISORY GROUP

Today's Presenter:

Tom Miller

President

(949) 265-5700

tmiller@vladvisors.com



Consultation Offer & Survey



Take advantage of one-hour consulting call with a VisionLink principal at no charge.

Indicate interest on final survey

Request a copy of our slides
and complimentary
consultation

We value your input.

Take our
SURVEY



THE VISIONLINK
ADVISORY GROUP

- Headquartered in Irvine, CA
- Founded in 1996
- Over 450 Clients throughout North America

7700 Irvine Center Dr., Ste. 930
Irvine, CA 92618
(888) 703 0080
www.vladvisors.com
www.phantomstockonline.com
www.bonusright.com

Today's Focus



Bonus Plan:

- 3 Reasons they Fail
- The Solutions
- Demo the steps
- Answer questions

The Survey



Only 10% of responders indicated they felt their annual incentive plan was effective.

- Larger companies
- Access to sophisticated consultants and experienced management
- What chance do the rest of us have?

(World at Work 2016 Survey)

Why?



Three Key Reasons

Number One: Most plans are
built on the wrong premise

The Wrong Premise



Influence Behavior Through Careful Selection of Plan Metrics

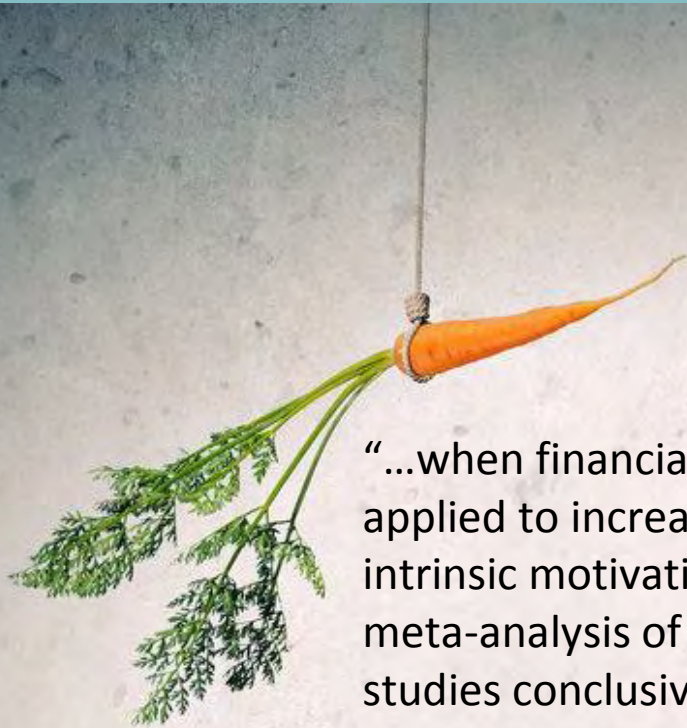
- Reward your employees for achieving results that are as close as possible to their job duties.
- “Select the best metrics” for each employee or at least for every department.
- Assume that all the collective mini-improvements will roll up into shareholder value creation.

When the plan isn't effective . . .

- Most employers re-double their efforts to find the “right metrics”
- More metrics (KPIs) are added to the plan formula to focus employees on behavioral outcomes
- Employees focus on the KPIs rather than the big picture



“Let’s change behavior”



“...when financial incentives are applied to increase...motivation, intrinsic motivation diminishes. A meta-analysis of 128 independent studies conclusively confirmed this effect.”

(“Stop Paying Executives for Performance,”
HBR, February 23, 2016)



Metrics Focus

8 Problems

1. Impossible to link every metric to true value creation.
2. Multiple KPIs create confusion and sap motivation.
3. A focus on behavior incentives can lead to the opposite behavior.
4. Difficult to find metrics for every position.
5. Results may be manipulated or loopholes exploited.
6. Impossible to equalize metrics across individuals and departments.
7. Unintended and unanticipated negative consequences.
8. Pursuit of “perfect” metrics is a time waster.



Results, not Methods



"You cannot hold people responsible for results if you supervise their methods."

(Stephen R. Covey)

Solution #1



- Take a step back and ask if employees understand the purpose of the incentive plan
- The purpose should be built around value creation and value sharing:
 - “When you help us create value you participate in that value”
 - Define value creation around the shareholders’ most important goals
- Dialogue

Shareholder's Most Important Result

Sustainable and growing profitability



Key Metric

Focus on One of These:

- Profit
- Increase in Profits (% or \$)
- (Sometimes: Revenue Growth)



Not Just Profit but Productivity Profit



Productivity profit is that surplus that can be attributable to the productivity of your people, not just your capital at work.

Example:

Item	Amount
Capital Account	\$20,000,000
Cost of Capital	12%
Capital Charge	\$2,400,000
Operating Income	\$10,000,000
Productivity Profit	\$7,600,000
Total Rewards Investment	\$25,000,000
ROTRI™ Return on Total Rewards Investment	30.4%

(ROTRI™ = Productivity Profit/Total Rewards Investment)

Example:

Item	Figure
Capital Account	\$20,000,000
Cost of Capital	12%
Capital Charge	\$2,400,000
Operating Income	\$10,000,000
*Productivity Profit	\$7,600,000
Total Rewards Investment	\$25,000,000
ROTRI™	30.4%

***Variable Pay Plans (Value Sharing) are financed from Productivity Profit**

(ROTRI™ = Productivity Profit/Total Rewards Investment)

Case Study



Core Changes

Shift from “Incentives” to “Value Sharing”

- Took away local measurements driving management incentive plans—all paid on same metrics
 - “We live together and we die together”
- Aligned everyone behind company success
 - “I call it ‘pay the company first.’ ”



Pay the Company First

“Basically, up to the company’s operating profit target, all of the profits go to the company; and only after that target is met, do we start funding the incentive pool.”

Example: If UL’s target is \$80 million--

- 100% of first \$80 in profit goes to company
- The next \$20 million goes to the incentive pool
- From there on, 50/50 between company & incentive pool

Pay the Company First

Once value creation is defined, compensation can follow a formula for sharing value in a way that aligns key producers with the company's business plan and priorities.



Setting Payout Thresholds

- Base
- Target (budget)
- Superior

Other Metrics



Minimum profit thresholds must be met first. Then...

- Department or team metrics
- Non-correlated factors (customer retention, customer or client increase, etc.)
- Individual performance metrics

Solution #1 leads to . . .

Every employee understanding:

- The importance of sustainable profits
- How those profits are generated
- How they can contribute to the generation of profits
- That bonuses are not guaranteed (they're based on value creation)
- How their variable pay programs work





Three Key Reasons

Number Two: Most plans mismanage the role of individual employee performance

Ways to treat individual performance



- Component of the allocation
- Discretion
- Modifier

Component of Allocation

- Allocation to plan participants contingent on:
 - **Company Performance** – Employees should have all or a majority portion of their bonus based on company performance
 - **Org Unit Performance** – A portion of an employee's bonus can be allocated based on department, location, division, or business unit
 - **Individual Performance** – A portion of the bonus is allocated to Individual Results



Problems

- Unless the slice is big, many employees will pay little attention to it
 - “I can still get 75% of my bonus without worrying about that piece”
- Performance management score may not be trustworthy
 - “I hate to give him a low score because it will reduce his bonus”



Problems

- Full (or even partial) discretion may lead to charges of unfairness or even discrimination
 - “Why was he paid more than me?”
- Lengthy list of employee goals may be hard to track fairly or accurately
 - “I didn’t get that done because you asked me to focus on something new”



Performance Management Headlines

Times Are Changing: The Future of Performance Management and Reviews

BY BUSINESS.COM EDITORIAL STAFF

Business.com / HR Solutions / Last Modified: February 22, 2017

SHARE THIS



Harvard Business Review Reinventing Performance Management

SUMMARY SAVE SHARE HH TEXT SIZE P

ASSESSING PERFORMANCE

Reinventing Performance Management

by Marcus Buckingham and Ashley Goodall



More big name organizations scrapped traditional performance appraisals and it's expected that significant changes will continue in 2016.



Product

Solutions

Customers

Resources

Contact Us

Log In

Free Trial

Performance Ratings Will Continue to Disappear

Placing employees on a number scale just doesn't work. It breeds competition and leads to a less productive workforce overall. Instead, more businesses will evaluate their staff by how successful each member is at working toward company goals. In a similar vein, business leaders should resist the temptation to make management decisions based on people analytics, CIO.com said. While this data can provide insight into skill levels, it doesn't mean much in the way of engagement. Instead, business leaders are on increasing employee satisfaction to deliver better long-term results.

Conversations Will Replace Annual Reviews

Organizations have already realized yearly assessments are an inefficient way of measuring performance. Business.com expects even more to come around in 2016. Annual reviews mean an average of about one hour of discussion to see how they're doing, then approximately 364 days to

Deloitte.

Search



Se

Insights

Performance management is broken
Replace "rank and yank" with coaching and development

Individual Performance

- Trend is to disconnect performance from incentive pay
- Performance Management is still important
- Managers more likely to be honest about performance if incentives are not directly correlated to performance rating
- If performance is deemed “Unacceptable” discretion should be utilized to eliminate incentive payment



Spot Bonuses

What about employees who made special contributions over the course of the year?

- Create a discretionary reserve inside of plan funding
- Reserved for “exceptional” performers only
- Point to clear contributions (the reason for the award)
- Immediate recognition (not end of the year)
- Nomination process
- Budget a “reserve” to fund these awards
- They don’t have to be big (\$500).



Solution #2 leads to . . .

Every employee understanding:

- How individual performance can influence variable pay
- That end-of-year awards are a celebration of team results





Three Key Reasons

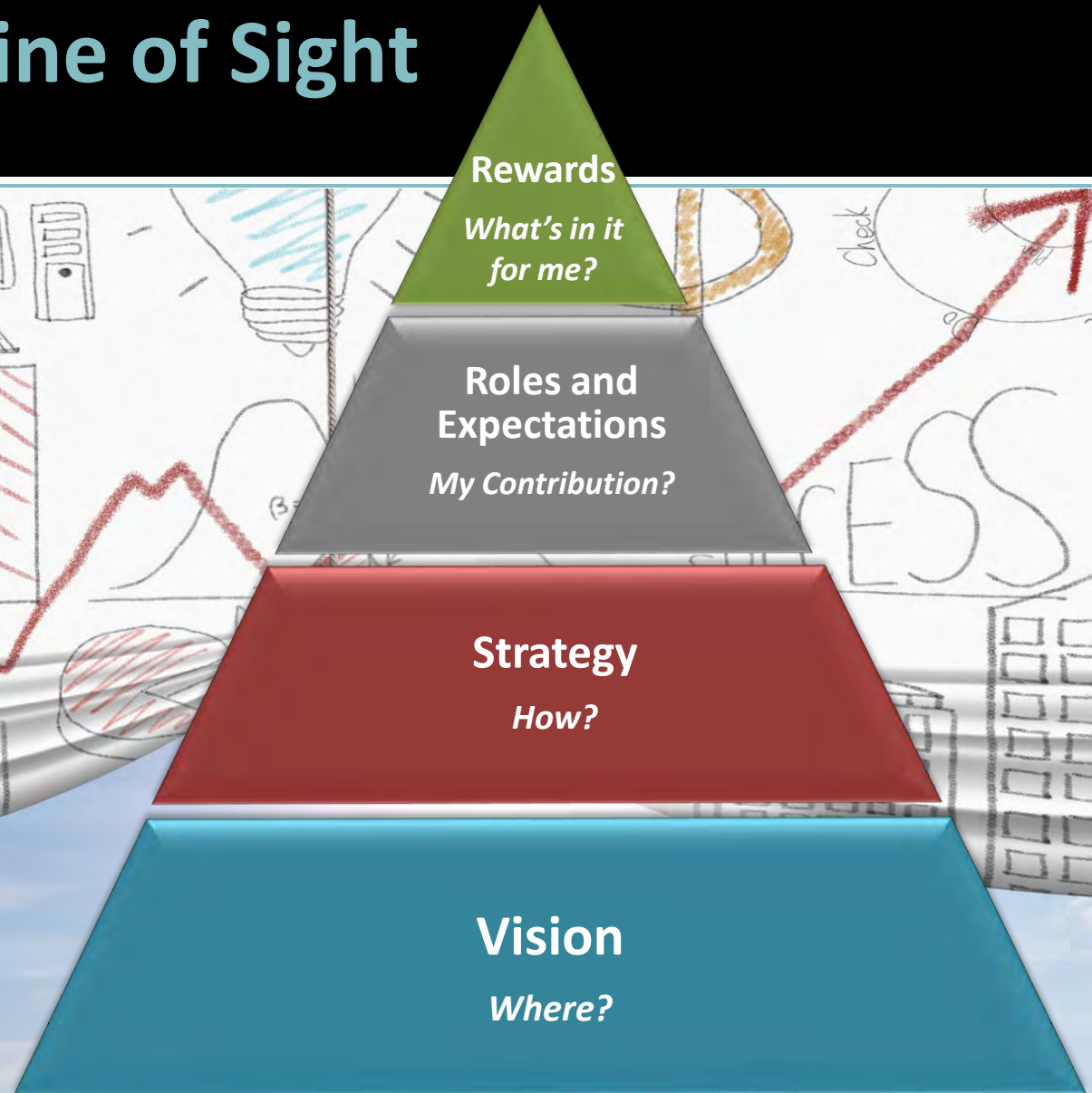
Number Three: Most plans
are not properly
communicated and reinforced

Communicate a Partnership



Engage employees in a conversation about the contributions they can make to profitable growth.

Reinforce Line of Sight



Communication

- ***The Key*** to the success of the plan
- Employee communication statements should communicate incentive target opportunity
- Regular performance updates during the plan year
- “Partners” understand basic company performance
- Private companies don’t always disclose all financial information to all employee “Partners”:
 - Financial performance in private companies communicated via percentage against target
 - “After Q1 we are tracking 95% against our ‘Target’ financial performance”

“Help me understand how the plan works”

“Help me understand what has to happen to optimize the value of the payout for me”

“Help me believe that we can achieve those results”

“Let me know how we’re doing regularly so I can make a difference”



“Talk with me about how I can contribute to those results”

Solution #3 leads to . . .



Every employee understanding:

- That they're being treated like partners in the success of the business
- What they can do to improve the value of the business and . . .
- How that aligns with their own rewards
- Everything more regularly (no surprises)

Let's do a quick demo

We'll explore how to handle employee performance

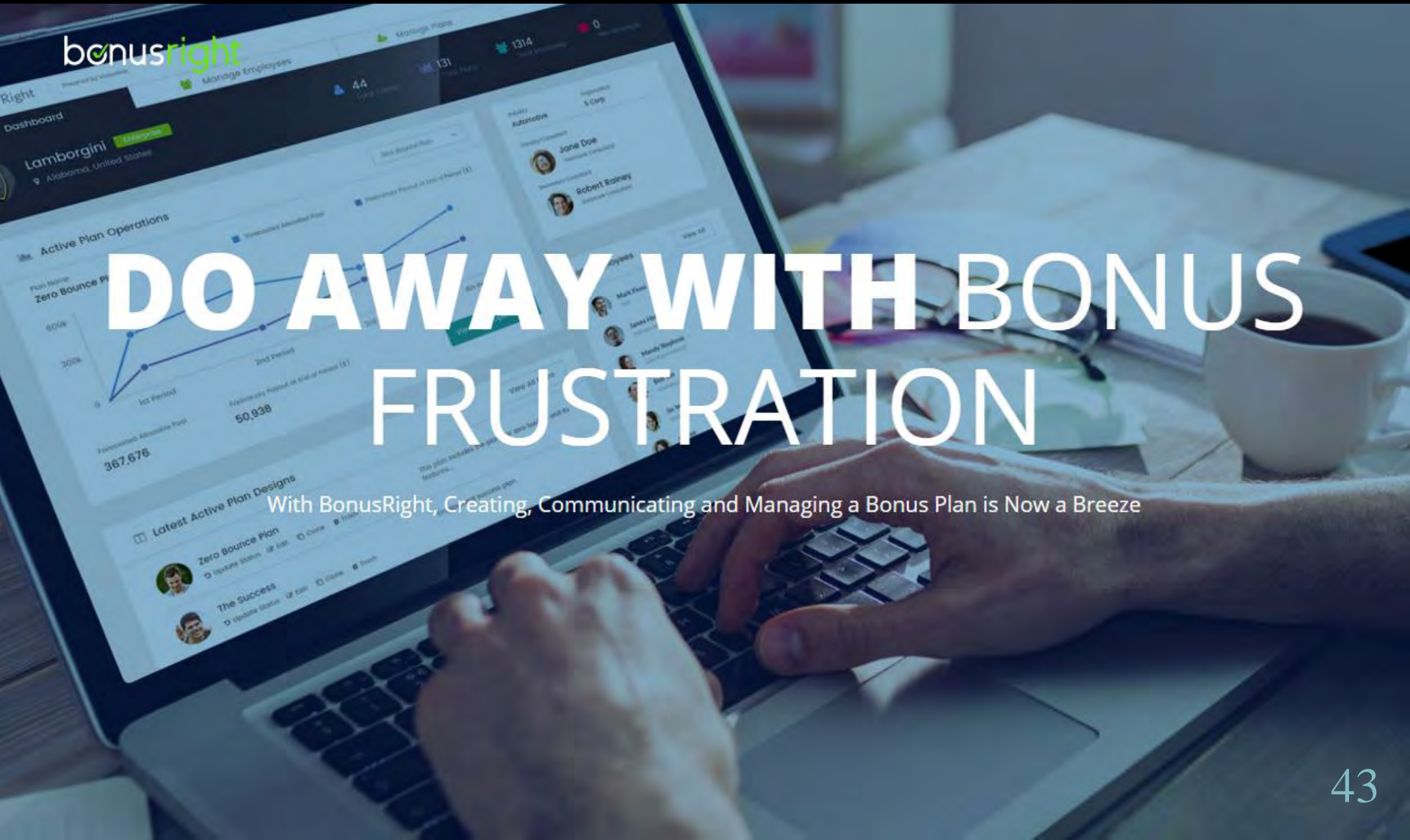


We'll look at a logical path for building a plan



We show you how to communicate the plan effectively

www.BonusRight.com



DO AWAY WITH BONUS FRUSTRATION

With BonusRight, Creating, Communicating and Managing a Bonus Plan is Now a Breeze

What will it do?

BUILD IT.
SHARE IT.
WORK IT.
RENEW IT.

Control every aspect of your bonus plan with one easy-to-use tool.

Build

Just upload your employee data; then follow six easy steps to create your plan. **Countless hours are a price you won't have to pay.**

Manage

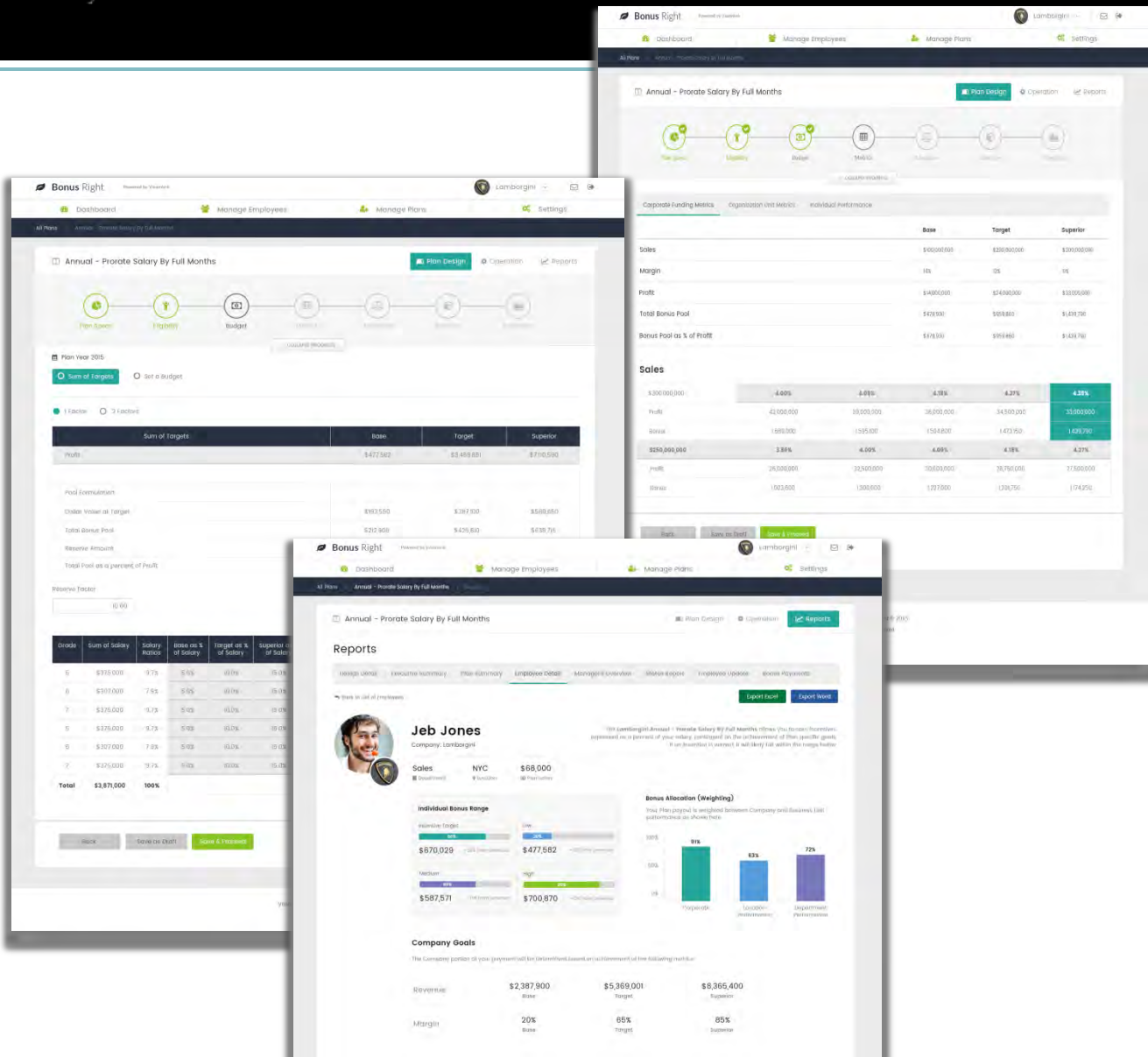
Add employees, reflect promotions, adjust your budget. **Plan changes are no longer your problem.**

Communicate

Introduce your plan, provide updates, promote success. **Clear expectations, clear results.**

Renew

Rollover or start over, begin again. **An end-to-end bonus plan with no speed bumps.**



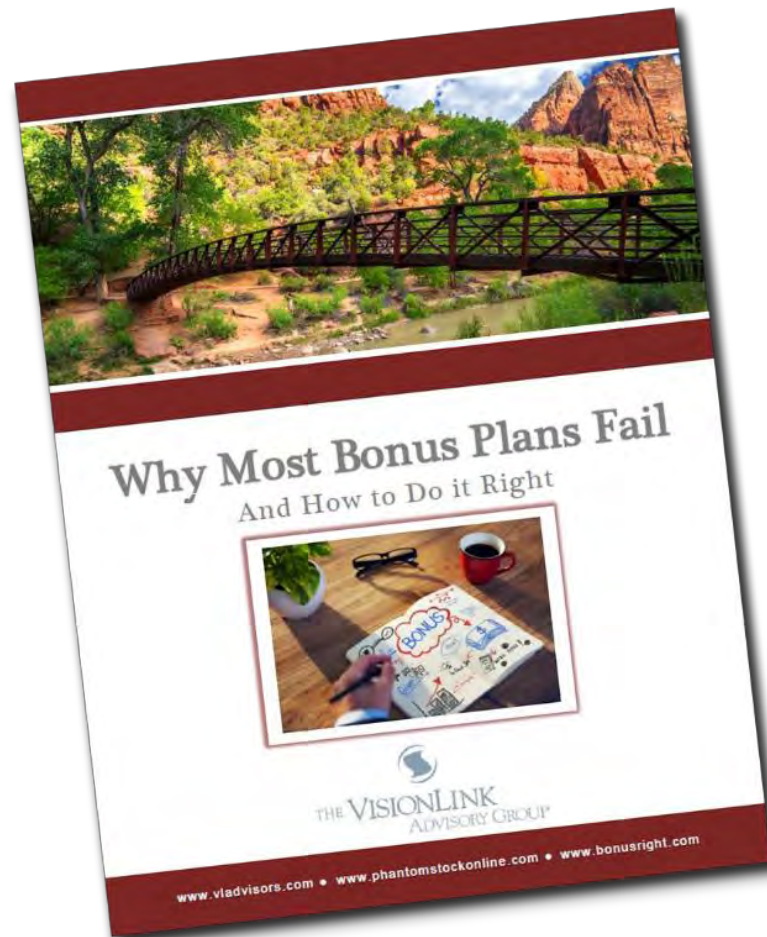
Indicate on survey if you would like more information including a demo (along with more info about our free trial).

A tall, modern skyscraper with a dark facade and many windows, standing prominently in a city skyline. The sky is a clear blue with a few white clouds. The text is overlaid on the right side of the image.

New Addition to BonusRight!

**Phantom Stock plan design
now available**

Free Report: **WHY MOST BONUS PLANS FAIL** (And How to Do it Right)



Request your copy on the attendee survey



Q&A



THE VISIONLINK
ADVISORY GROUP

Today's Presenter:

Tom Miller

President

(949) 265-5700

tmiller@vladvisors.com



Thank You!

7700 Irvine Center Drive, Suite 930 ♦ Irvine, CA 92618 ♦ 949-852-2288

www.VLadvisors.com ♦ www.PhantomStockOnline.com ♦ www.BonusRight.com

+ B2B
 COMPENSATION DESIGN
 & MANAGEMENT

ESTABLISHED IN 1996



+ Our Focus
 BE CEO GROWTH
 PARTNER

DESIGN COMP THAT DRIVES RESULTS
 SUPPORT WEALTH MUTIPLIERS
 ATTRACT & RETAIN GREAT TALENT
 ENABLE AN ENGAGED,
 COMMITTED WORKFORCE



+ Client Profile

MIDDLE-MARKET COMPANIES
 GROWTH ORIENTED
 RESULTS CENTERED
 DEFINED BUSINESS MODEL

+ Seasoned Team

7 WITH BACKGROUNDS IN:
 COMPENSATION DESIGN
 HUMAN RESOURCES
 EXECUTIVE BENEFITS
 LAW
 FINANCE
 PROFESSIONALS

+ Reach

CLIENTS IN 40+ STATES
 BREADTH OF INDUSTRIES

OVER **500**
 CLIENTS SERVED

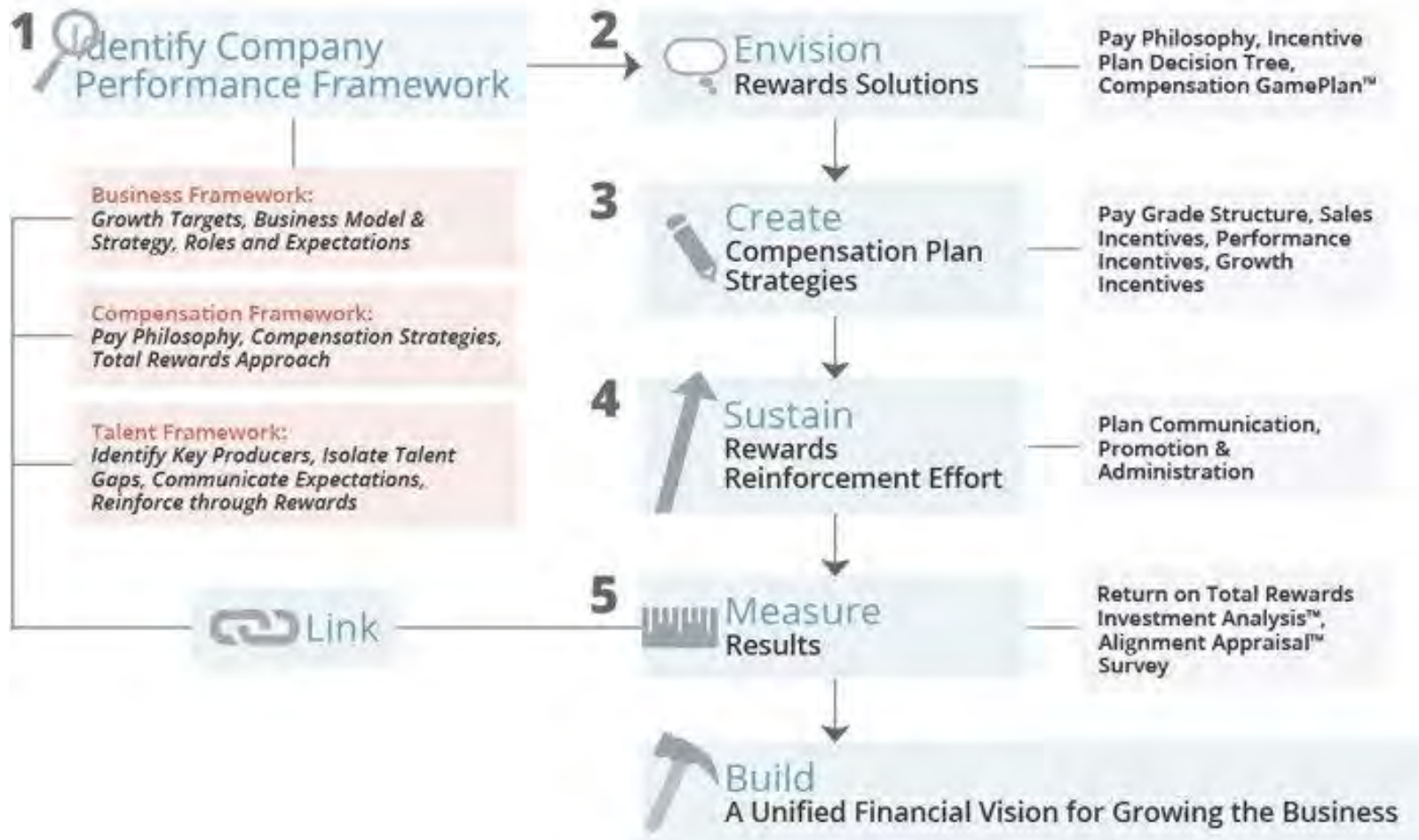
+ Our Commitment

DRIVE GROWTH
 INCREASE VALUE



THE VISIONLINK
 ADVISORY GROUP







THE VISIONLINK
ADVISORY GROUP

7700 Irvine Center Dr., Ste. 930
Irvine, CA 92618
(888) 703 0080
www.vladvisors.com
www.phantomstockonline.com
www.bonusright.com

